

PUBLIC UTILITIES COMMISSION

505 VAN NESS AVENUE
SAN FRANCISCO, CA 94102-3298



March 19, 2003

Agenda ID #1966

TO: PARTIES OF RECORD IN APPLICATION 02-07-021

This is the proposed decision of Administrative Law Judge (ALJ) Evans, previously designated as the principal hearing officer in this proceeding. It will not appear on the Commission's agenda for at least 30 days after the date it is mailed. This matter was categorized as ratesetting and is subject to Pub. Util. Code § 1701.3(c). Pursuant to Resolution ALJ-180 a Ratesetting Deliberative Meeting to consider this matter may be held upon the request of any Commissioner. If that occurs, the Commission will prepare and mail an agenda for the Ratesetting Deliberative Meeting 10 days before hand, and will advise the parties of this fact, and of the related ex parte communications prohibition period.

The Commission may act at the regular meeting, or it may postpone action until later. If action is postponed, the Commission will announce whether and when there will be a further prohibition on communications.

When the Commission acts on the proposed decision, it may adopt all or part of it as written, amend or modify it, or set it aside and prepare its own decision. Only when the Commission acts does the decision become binding on the parties.

Parties to the proceeding may file comments on the proposed decision as provided in Article 19 of the Commission's "Rules of Practice and Procedure." These rules are accessible on the Commission's website at <http://www.cpuc.ca.gov>. Pursuant to Rule 77.3 opening comments shall not exceed 15 pages. Finally, comments must be served separately on the ALJ and the assigned Commissioner, and for that purpose I suggest hand delivery, overnight mail, or other expeditious method of service.

/s/ ANGELA K. MINKIN by PSW
Angela K. Minkin, Chief
Administrative Law Judge

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Decision **PROPOSED DECISION OF ALJ EVANS** (Mailed 3/19/2003)**BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA**

In the Matter of the Application of Southern California Water Company (U 133 W) for an Order pursuant to Public Utilities Code Section 851 Approving a Settlement Agreement that will Convey Water Rights in the Culver City Customer Service Area.

Application 02-07-021
(Filed July 11, 2002)

Patricia A. Schmiede, Attorney at Law, and
Susan L. Conway, for Southern California Water
Company, applicant.

Joseph Lawrence, Attorney at Law, and Nossaman,
Guthner, Knox & Elliott, LLP, by Martin Mattes,
Attorney at Law, for the City of Santa Monica,
interested parties.

James E. Scarff, Attorney at Law, and Sung Han for the
Office of Ratepayer Advocates.

O P I N I O N**I. Summary**

This order approves a Settlement between the City of San Monica (City) and the Southern California Water Company (SCWC) that will effectuate the proposed conveyance of water rights to the City and thereby also resolve SCWC's participation in a series of pending lawsuits related to the Charnock Groundwater Basin (Basin). It defers the issue of ratemaking treatment of the Settlement proceeds to a new proceeding.

II. Introduction

During various periods since the 1920s, SCWC has relied on groundwater pumped from the Basin for a portion of its water supply for its Culver City Customer Service Area (Culver City CSA). In 1996, the Basin's groundwater was found to be contaminated with gasoline and gasoline additives, primarily methyl tertiary butyl ether (MTBE). Both the City, which also pumps from the Basin, and SCWC asserted damage claims, and eventually filed lawsuits against various oil companies and gasoline station owners and operators (Polluters) because the contamination disrupted the City's and SCWC's ability to use groundwater from the Basin (Contamination Lawsuits).

SCWC and the City also disputed each other's respective rights to pump groundwater from the Basin. The value of the City's and SCWC's respective damage claims in the Contamination Lawsuits was based on each entity's right to pump groundwater from the Basin. Accordingly, the City and SCWC sued one another over their respective rights to pump groundwater from the Basin (Water Rights Lawsuit).

Now, by this application, SCWC seeks approval of the Settlement, whereby:

- SCWC can avoid further expenses associated with the Contamination Lawsuits by assigning to the City all of SCWC's rights and liabilities arising out of the contamination of the Basin and the Contamination Lawsuits;
- SCWC can avoid further expenses associated with the Water Rights Lawsuit by conveying to the City all of SCWC's rights to pump groundwater from the Basin; and

- In exchange for the above assignment and conveyance, SCWC will receive payment from the City equal to the fair market value of certain groundwater rights in the Basin, plus the value of SCWC's Basin groundwater production, treatment and distribution facilities.

III. Background

A. SCWC's Culver City Customer Service Area

The Culver City CSA is located within Culver City, in Los Angeles County. The Culver City CSA water system facilities form an integrated, single water supply system serving customers in Culver City. As of March 31, 2002, SCWC provided water service to approximately 9,400 metered customers in the Culver City CSA. The majority of those customers are residential users, with some commercial customers and a small number of industrial customers.

The Culver City CSA receives water from two sources: groundwater pumped from the Basin, and purchased water obtained from the West Basin Municipal Water District (a member agency of the Metropolitan Water District of Southern California.) Since water service from the West Basin became available in the mid-1950s, purchased water is the primary source of supply to the Culver City CSA. Although SCWC retains and maintains some groundwater production in the Basin, in the past three decades the Basin delivered only small amounts of groundwater to the Culver City CSA.

B. The Charnock Groundwater Basin

The Basin is located in the Los Angeles Coastal Plain in western Los Angeles County. The Basin is bounded by the Santa Monica Mountains on the north, the Overland Avenue Fault on the east, the Ballona Escarpment and Baldwin Hills on the south and by the Charnock Fault on the west.

The Basin is relatively small, as groundwater basins are measured. The long-term average annual yield of the Basin is estimated in various published reports as less than 7,500 acre-feet per year (AFY). However, there is disagreement regarding the Basin's safe yield, and this issue has not been litigated. In addition to the MTBE in the groundwater, the Basin has high concentrations of minerals (high total dissolved solids) and has been impacted by other chemicals such as perchlorethylene and trichloroethylene. The groundwater requires treatment and/or blending with high quality West Basin water before it is suitable for consumption.

C. SCWC's Groundwater Production Facilities in the Basin

SCWC has two production wells in the Basin with a total gross capacity of approximately 3,300 AFY, with wellhead treatment capacity of some 2,500 AFY. In addition to the two wells and treatment equipment, SCWC owns pumps, manifolds, a forebay, reservoirs and other associated groundwater transmission and blending facilities.

D. Historic Basin Groundwater Production

The City and SCWC have both relied on Basin groundwater in varying degrees since the 1920s. Prior to the early 1950s, Basin groundwater was the only source of supply to the Culver City CSA. However, since the early 1950s, SCWC reliance on this source decreased substantially for the following reasons:

- In 1952, SCWC sold approximately one-third of its then existing Culver City CSA to the City of Los Angeles, thereby reducing its water supply needs;
- A higher-quality, low-cost water supply became available through the West Basin Municipal Water District;

- The quality of the Basin groundwater was substantially inferior to purchased water, and treatment was not cost-effective; and
- The Basin did not have the long-term capacity (safe yield) to provide a reliable source of supply to both the City and to SCWC, unless one or both reduced their level of reliance.

Since the early 1970s, the City has made significant investments in its groundwater extraction infrastructure and has substantially increased its production of groundwater from the Basin. During this period, the City's average groundwater use was approximately 6,500 AFY (nearly the entire safe yield of the Basin), and peaked as high as 8,100 AFY.

In the meantime, SCWC relied more heavily on better-quality, cost-effective purchased water from West Basin. During this same period (since the 1970s), SCWC's maximum annual groundwater production was approximately 700 AFY. On average, SCWC produced less than 500 AFY of Basin groundwater during the last three decades.

In the early 1990s, SCWC began investing in and upgrading its Basin groundwater production facilities. By 1994, SCWC had refurbished its two Basin groundwater wells and constructed a wellhead treatment system suitable to improve the quality of the Basin's groundwater. Before these facilities could be used to meaningfully benefit the Culver City CSA, the MTBE contamination was discovered, and all groundwater production from the Basin was terminated.

E. Contamination of Basin Groundwater by MTBE and Other Gasoline-Based Chemicals

In 1996, both the City and SCWC ceased producing groundwater from the Basin because of the presence of high levels of MTBE, tertiary butyl ether and

other gasoline-based pollutants (collectively, MTBE contamination). MTBE is used as an oxygenate in reformulated gasoline to produce cleaner burning fuel, thereby reducing air pollution. The California Department of Health Services (DHS) considers MTBE a potential human carcinogen when ingested. MTBE is especially problematic once introduced into a water supply because it is highly water-soluble and, therefore, spreads rapidly through the water supply.

Most experts believe that the MTBE contamination was introduced into the Basin by leaking underground storage tanks and/or pipelines owned or operated by the Polluters. Initially, the City and SCWC were successful in getting many of the Polluters to consider accelerated methods of remediating the MTBE contamination. In addition, as a result of the City's and SCWC's aggressive efforts to protect the Basin groundwater resources, the federal Environmental Protective Agency (EPA) and the Los Angeles Regional Water Quality Control Board (RWQCB) initiated a joint enforcement action against the Polluters. The EPA and RWQCB issued several administrative orders against individual Polluters.

The City and SCWC were successful in negotiating interim settlement agreements with the Polluters, whereby SCWC received partial reimbursement for its technical consultant costs and reimbursement for some of its replacement water costs associated with responding to the MTBE contamination. However, the Polluters later sought to terminate the interim settlement agreements with the City and SCWC, and this dispute is now before the Superior Court of Orange County. The polluters also put SCWC on notice of the Polluters' claim of having overpaid SCWC. This claim is a contingent liability for SCWC that the City will assume as a result of the terms of the Settlement.

SCWC states that after exhaustive efforts in attempting, but ultimately failing, to negotiate a permanent settlement, both the City and SCWC filed separate lawsuits against the Polluters (Contamination Lawsuits). Both lawsuits are similar in seeking, among other relief, monetary damages for loss of the ability to use Basin groundwater as a result of the contamination. A copy of SCWC's lawsuit is Exhibit B to the application.

F. SCWC's Water Rights

SCWC notes that since the safe yield of the Basin is quantifiable, it was clear from the onset that the City and SCWC would inevitably be competing for a finite total damage recovery from the Polluters. Either the City or SCWC would lose if both entities asserted claims to the entire safe yield of the Basin.

The City and SCWC began negotiating a settlement of the competing claims to Basin groundwater as soon as the conflict with the Polluters arose. SCWC attempted to negotiate a settlement that would have divided the Basin yield between the entities. Having exhausted these initial efforts to compromise, SCWC filed its Water Rights Lawsuit against the City on January 4, 2001. The City filed a cross-complaint shortly thereafter. Copies of these two filings are included with the application as Exhibits C and D respectively. To make matters more complex, several of the Polluters attempted to intervene in the Water Rights Lawsuit. Ultimately, the City and SCWC reached the Settlement, which is included as Exhibit A to the application.

G. The Terms of the SCWC-City Settlement

SCWC states that the Settlement fully resolves SCWC's role in the Contamination Lawsuits and in the Water Rights Lawsuit. The City and SCWC executed the Settlement on March 19, 2002, subject to approval by this Commission. The essential provisions of the Settlement are as follows:

- SCWC assigned and transferred to the City any and all of its rights under the Contamination Lawsuits, and agreed that the City could prosecute any and all of SCWC's claims associated with those actions.
- The City will purchase, and SCWC will sell to the City, all of SCWC's water rights in the Basin. The purchase price is based upon the fair market value of 1,050 AF of groundwater rights in the Basin, to be conditionally valued as if the Basin was uncontaminated. The City has paid SCWC a deposit of \$150,000. The remainder of the purchase price will be paid after the earlier of: (a) 180 days from the settlement of, or final court judgment in, the Contamination Lawsuits; or (b) five years from the execution of the Settlement (March 2007).
- In a similar time frame as the water rights payment described above, the City will pay SCWC an amount equal to the fair market value of SCWC's groundwater wells, treatment system and associated groundwater distribution systems in the Basin. SCWC will retain its ownership of this infrastructure, however.
- The City will defend and indemnify SCWC against all claims by the Polluters to recover payment received by SCWC under the interim settlement with the Polluters described above.

IV. Position of the Parties

At the November 8, 2002 Prehearing Conference (PHC), the City requested that the Commission issue an interim decision addressing the merits of the settlement between the City and SCWC, but defer resolution of ratemaking treatment of money received by SCWC under the Settlement. Both SCWC and the Office of Ratepayer Advocates (ORA) opposed this request. SCWC and ORA believed the ratemaking issues were not separable from the settlement.

The City noted that as part of the interim settlement agreement between the City and the Polluters, there was a provision that allowed the Polluters to void the agreement if any part of the Settlement between the City and SCWC is not effective. The City noted that it needs to remove any “cloud” that might exist, so there is no possibility that the Settlement between the City and SCWC might be unwound, and so the City can pursue claims against the polluters to achieve a cleanup of the water supply of the Basin. Finally, the City believes that if this Settlement is approved by the Commission or is in the process of being approved, the Superior Court of Orange County is more likely to approve a settlement between the City and the Polluters.

At the one-day hearing on March 4, 2003, SCWC, the City and ORA presented their respective exhibits and testimony. Most of the testimony and cross-examination addressed the ratemaking aspects of the Settlement between SCWC and the City and the merits of the Settlement. SCWC’s position is that the net proceeds from the Settlement should be invested in rate base pursuant to Pub. Util. Code § 790.¹ Essentially, ORA’s position is that the Settlement should not be approved unless all of the net proceeds of the sale accrue to the ratepayers. However, the ORA witness, under cross-examination by the City, indicated that if the Commission approved the Settlement, the net proceeds of the sale could be determined at a later date.

V. Discussion

There are two questions we must answer:

¹ Section 790 provides for reinvestment of the net proceeds from the sale of real property that is no longer used and useful.

- Is the Settlement between the City and SCWC reasonable?
- Are the ratepayers harmed if we separate approval of the sale of SCWC's groundwater rights and associated property from determination of the ratemaking treatment of money received by SCWC under the terms of this Settlement?

We believe the Settlement is reasonable. SCWC will receive payment from the City for SCWC's water rights in the Charnock Basin equal to fair market value. The City will pay SCWC an amount equal to the fair market value of SCWC's groundwater wells, treatment system and associated groundwater distribution systems in the Basin, and the City will defend and indemnify SCWC against all claims by the Polluters to recover payments received by SCWC under the interim settlement agreements with the Polluters.

Not only does fair market value appear to be a reasonable and appropriate basis for pricing the water rights and associated equipment, but in addition SCWC, and ultimately its ratepayers, avoid potential costly litigation with the City over the pumping rights in the Basin.

Both ORA and SCWC seemed to believe the allocation of Settlement proceeds are more or less entwined with an evaluation of the merits of the Settlement, although ORA's witness conceded that if the Commission approved the Settlement between SCWC and the City, the ratemaking treatment of the net proceeds could be determined at a later date. We see no connection between our approval of the Settlement and the ultimate ratemaking treatment of the money SCWC receives under the terms of the Settlement. There are many instances

where the Commission has separated the ratemaking treatment from approval of a sale of utility property.²

Given the fact that the fair market value of the water rights and related equipment needs to be determined and the fact that we do not know with specificity how SCWC intends to invest the net proceeds, we will direct SCWC to file a new application after the valuation of the fair market value has been determined and the net proceeds are known. SCWC will need to provide specific details as to its reinvestment plans. SCWC may satisfy this requirement by including this compliance in a General Rate Case or in a separate application.

We conclude that it is in the best interest of all the parties, the City, SCWC, ORA and the ratepayers of the Culver City CSA to approve the Settlement between SCWC and the City. We do not wish to jeopardize the settlement agreement between the City and the Polluters; consequently, approval of the sale should not be delayed in order to resolve the ratemaking treatment of the sale proceeds. We see no reason to condition the approval of the Settlement between the City and SCWC on a particular disposition of the proceeds, as ORA and SCWC suggest.

As SCWC notes in its application: “The settlement achieves the necessary reimbursement for SCWC’s lost groundwater supply and allows SCWC to focus on the primary objective of providing good quality, cost-effective water service without the distraction or financial drain of complex litigation.” We agree.

² See e.g., D.01-10-051, where the Commission approved a sale and concluded that the issue of the gain-on-sale should be deferred to another proceeding.

VI. Comments on Proposed Decision

The proposed decision of the ALJ in this matter was mailed to the parties in accordance with Pub. Util. Code § 311(d) and Rule 77.1 of the Rules of Practice and Procedure. Comments were filed on _____, and reply comments were filed on _____.

VII. Assignment of Proceeding

Susan P. Kennedy is the Assigned Commissioner, and Dean Evans is the assigned Administrative Law Judge in this proceeding.

Findings of Fact

1. The Basin's water rights have been unavailable for SCWC's customers due to high levels of contamination.
2. The proposed Settlement between SCWC and the City benefits SCWC, the City and the ratepayers.
3. The purchase price for SCWC groundwater rights in the Charnock Basin is based on the fair market value of 1,050 AF, conditionally valued as if the Basin was uncontaminated.
4. The Settlement compensates SCWC for the groundwater rights in excess of its recent extractions from the Basin.
5. The purchase price of SCWC's wells, distribution piping, treatment facilities and reservoir is based on fair market value.
6. The City has a settlement with the Polluters pending.
7. The Superior Court of Orange County has scheduled a "good faith settlement" hearing for March 24, 2003, regarding the litigation between the City and the Polluters.
8. The determination of the ratemaking treatment of the money received by SCWC from the Settlement should be deferred to a new proceeding.

Conclusions of Law

1. The proposed Settlement between the City and SCWC is reasonable.
2. It is reasonable to defer resolution of the ratemaking issues arising from the proposed Settlement.
3. Determining the value of SCWC's groundwater rights at fair market value is reasonable.
4. Determining the value of SCWC's wells, distribution piping, treatment facilities and reservoir at fair market value is reasonable.
5. Today's order should be made effective immediately.

O R D E R

IT IS ORDERED that:

1. The Settlement Agreement between the Southern California Water Company (SCWC) and the City of Santa Monica is approved.
2. SCWC shall file a new application, including how it intends to invest the net proceeds, within 90 days after it has determined the value of the net proceeds from the Settlement Agreement with the City; alternatively, SCWC may file its request as part of its next scheduled General Rate Case.
3. This proceeding is closed.

This order is effective today.

Dated _____, at San Francisco, California.